

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

ALAN LEFORT, derivatively and
on behalf of OPENWAVE SYSTEMS,
INC,

No C 02-2465 VRW

ORDER

Plaintiff,

v

ALAN BLACK, ROGER EVANS, ANDREW
VERHALEN, ALAIN ROSSMANN,
CHARLES PARRISH, DAVID
KRONFELD, REED HUNDT, CREDIT
SUISSE FIRST BOSTON
CORPORATION, ROBERTSON
STEPHENS, INC, fka BANCOSTON
ROBERTSON STEPHENS, INC, and
DOES 1-25 inclusive,

Defendants,

and

OPENWAVE SYSTEMS, INC,

Nominal Defendant.

_____ /

Plaintiff commenced this shareholder derivative action
in San Mateo County superior court on May 3, 2002. See Compl
(Doc #1, Exh A). Defendant Credit Suisse First Boston

1 Corporation (CSFB) answered on May 20, 2002. See CSFB Ans (Doc
2 #1, Exh B). At the time CSFB filed its answer, neither CSFB nor
3 any other defendant - in particular, no in-state defendant - had
4 been served. See Not of Rem (Doc #1) at 2, ¶3. The next day,
5 CSFB removed the action on diversity grounds, before plaintiff
6 could serve any defendant alleged to be a citizen of California
7 for purposes of jurisdiction. See Not of Rem (Doc #1).

8 On November 5, 2002, plaintiff filed a first amended
9 complaint (FAC) in this court. Doc #59. Plaintiff then moved
10 to transfer venue to the Southern District of New York. Doc #

11 28. On November 19, 2002, plaintiff's motion was denied.
12 Doc #60. Defendants then separately filed motions to dismiss.
13 See Docs ##61, 63, 67. Because the argument advanced in the
14 motion to dismiss filed by CSFB and joined by Robertson
15 Stephens, Inc (Robertson Stephens) (Docs ##61, 62) had the
16 potential to result in dismissal of the complaint in its
17 entirety, the parties stipulated and the court ordered that
18 hearing on the motions to dismiss filed by the individual and
19 nominal defendants would be deferred until the court ruled on
20 CSFB's motion. See Doc #74.

21 This order, therefore, addresses only CSFB's motion to
22 dismiss (Doc #61). For the reasons detailed below, that motion
23 (Doc #61) is GRANTED. Because the court finds this matter
24 suitable for determination without oral argument, the hearing
25 scheduled for March 27, 2003, is VACATED. See Civ LR 7-1(b).

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I

In the FAC, plaintiff alleges that CSFB and Robertson Stephens (collectively, underwriter defendants) acted as lead underwriters for the initial public offering (IPO) of common stock in nominal defendant Openwave Systems, Inc (Openwave). The FAC alleges that the underwriter defendants worked with Openwave deliberately to underprice the shares issued in the IPO. See FAC (Doc #59), ¶¶ 40-52. As a result of this underpricing, the FAC alleges that the underwriter defendants were able to secure large profits for favored customers at a cost to Openwave of as much as \$96 million. See id, ¶88. The FAC states causes of action against the individual defendants for breach of fiduciary duty, unjust enrichment and negligence and against the underwriter defendants for breach of fiduciary duty, unjust enrichment and breach of the duties of agent to principal. See id, ¶¶81-120.

Tellingly, the FAC nowhere alleges that plaintiff owned shares of Openwave stock on or before the date of the Openwave IPO, June 10, 1999. By its nature, the wrongful conduct alleged in the FAC - the improper fixing of Openwave's opening stock price - must have occurred, if at all, on or before that date. See FAC, ¶¶12, 76.

II

In considering a motion to dismiss under FRCP 12(b)(6), the court must take the material allegations of the complaint as true and construe them in the light most favorable to plaintiff. See Pareto v FDIC, 139 F3d 696, 699 (9th Cir 1998). The court

1 should dismiss a cause of action only if it "appears beyond
 2 doubt that the plaintiff can prove no set of facts in support of
 3 its claim which would entitle him to relief." Conley v Gibson,
 4 355 US 41, 45-46 (1957). The court is not "required to accept
 5 as true allegations that are merely conclusory, unwarranted
 6 deductions of fact, or unreasonable inferences." Sprewell, 266
 7 F3d at 988 (citing Clegg v Cult Awareness Network, 18 F3d 752,
 8 754-55 (9th Cir 1994)). It is accordingly improper "[to] assume
 9 that [plaintiff] can prove facts that [he] has not alleged."
 10 Associated General Contractors of California, Inc v California
 11 State Council of Carpenters, 459 US 519, 526 (1983).

12 Federal Rule of Civil Procedure 23.1 sets forth the
 13 procedural requirements for bringing a derivative action in
 14 federal court. It requires, inter alia, that "the complaint * *
 15 * shall allege [] that the plaintiff was a shareholder * * * at
 16 the time of the transaction of which the plaintiff complains * *
 17 *." FRCP 23.1. This rule has consistently been read to state
 18 an additional requirement that plaintiff must retain ownership
 19 of shares of the stock at issue for the duration of the lawsuit:
 20 the so-called continuous share ownership requirement. See Lewis
 21 v Chiles, 719 F2d 1044, 1048 (9th Cir 1983).

22 Under the doctrine first articulated in Erie Railroad
 23 Co v Tompkins, 304 US 64 (1938), a federal court sitting in
 24 diversity applies federal law to procedural matters and the law
 25 of the state in which it sits to substantive matters. See *id* at
 26 78; Gasperini v Center for Humanities, 518 US 415, 427 (1996).
 27 The goals of the Erie doctrine are to discourage forum-shopping
 28 between state and federal courthouses and to minimize the

1 unfairness inherent in a system in which non-resident parties
2 have access to a forum unavailable to resident parties. See
3 Guaranty Trust Co fo New York v York, 326 US 99, 109 (1945);
4 Hanna v Plumer, 380 US 460, 467 (1965). The effect of Erie is
5 to guarantee that "a federal court adjudicating a state-created
6 right solely because of the diversity of citizenship of the
7 parties is for that purpose, in effect, only another court of
8 the State." Guaranty Trust, 326 US at 108.

9 In Kona Enterprises, Inc v Estate of Bishop, 179 F3d
10 767 (9th Cir 1999), the Ninth Circuit established that "Rule
11 23.1's continuous share ownership requirement is procedural in
12 nature and thus applicable in diversity actions." Id at 769
13 (internal citation omitted); see also Sax v World Wide Press,
14 809 F2d 610, 613 (9th Cir 1987). As the Lewis court had earlier
15 explained in discussing the implications of Rule 23.1, "Congress
16 has the power to fashion rules of procedure which affect the
17 manner in which state-created rights are enforced in federal
18 courts." Lewis, 719 F2d at 1048 n 4 (9th Cir 1983) (citing
19 Hanna, 380 US at 460 ff).

20 The court of appeals in Kona held that plaintiffs'
21 "failure to own stock in [nominal defendant] contemporaneously
22 with bringing suit deprives them of standing to pursue their
23 claims derivatively." See Kona, 179 F3d at 769. The appellate
24 panel rejected plaintiffs' arguments that they should be
25 accorded equitable standing and confirmed the district court's
26 holding that plaintiffs lacked standing to pursue their
27 derivative claims. See id at 770. The grounds for equitable
28 standing asserted by plaintiffs and rejected by the court of

1 appeals in Kona - based on case law involving bank foreclosures
2 and corporate mergers - are not applicable to the instant
3 action.

4 Plaintiff has alleged no facts supporting an inference
5 that he owned Openwave stock at the time of the IPO. Indeed he
6 candidly concedes that he "does not satisfy the contemporaneous
7 [share] ownership requirement of [FRCP] 23.1." Pl Opp (Doc #75)
8 at 1. That fact is precisely the reason plaintiff filed the
9 original complaint in state court, because California law allows
10 for an exception to the contemporaneous share ownership
11 requirement under certain conditions. Section 800(b)(1) of the
12 California Corporations Code permits a derivative plaintiff who
13 cannot demonstrate stock ownership at the time of the alleged
14 wrongful conduct nevertheless to proceed with an action in state
15 court if that plaintiff can demonstrate that:

16 (i)there is a strong prima facie case in favor of the
17 claim asserted on behalf of the corporation, (ii) no
18 other similar action has been or is likely to be
19 instituted, (iii) the plaintiff acquired the shares
20 before there was a disclosure to the public or to the
21 plaintiff of the wrongdoing of which plaintiff
22 complains, (iv) unless the action can be maintained the
23 defendant may retain a gain derived from defendant's
24 willful breach of a fiduciary duty, and (v) the
25 requested relief will not result in unjust enrichment
26 of the corporation or any shareholder of the
27 corporation, and [the plaintiff has met the other
28 requirements for bringing such an action].

Id.

 "The Supreme Court has never resolved the issue whether
Rule 23.1(1) acts as a bar in a diversity case where state law
permits a noncontemporaneous shareholder to maintain a
derivative action." Lewis, 719 F2d at 1048 n4. As discussed
above, however, Ninth Circuit case law establishes that the

1 requirements of FRCP 23.1 are procedural, hence applicable in a
2 diversity action. Since plaintiff, by his own admission, cannot
3 meet one of the two requirements, plaintiff lacks standing to
4 pursue this action in this court.

5 Plaintiff's quandary is this: He filed an action in
6 state court seeking to take advantage of the exception to the
7 contemporaneous share ownership requirement embodied in
8 California Corporations Code §800(b)(1). Before he was able to
9 effect service on the in-state defendants in this action, CSFB
10 removed the matter to federal court. Because plaintiff is a
11 Florida resident, diversity is complete and remand unobtainable.
12 Yet plaintiff lacks standing to pursue this action in federal
13 court, because he is barred from doing so by a federal rule the
14 Ninth Circuit has held to be procedural, thus applicable in
15 diversity actions.

16 Rather than arguing that he possesses standing to
17 proceed further in this court, plaintiff argues that the court
18 should remand the action to avoid the complete extinction of
19 plaintiff's case as a result of defendant's strategic reliance
20 on the federal removal statute and the Federal Rules of Civil
21 Procedure. In the alternative, plaintiff argues that the court
22 should dismiss this action without prejudice.

23 In support of remand, plaintiff cites the suggested
24 resolution of this problem in Wright & Miller: "the district
25 court should be encouraged to remand a case for failure to
26 comply with Rule 23.1(1) rather than to dismiss it. The scope
27 of the current federal statute authorizing the remand of cases
28 appears sufficiently broad to give the court discretion to

1 accomplish this." C Wright and A Miller, 7C Fed Prac & Proc Civ
2 2d (Wright and Miller) §1829 (2002).

3 Plaintiffs' reliance on this suggestion is misplaced,
4 however, as it in turn relies on an interpretation of a
5 superceded portion of the federal removal statute. Prior to the
6 1988 Amendments to 28 USC §1447, subsection (c) read, "If at any
7 time before final judgment it appears that the case was removed
8 improvidently and without jurisdiction, the district court shall
9 remand the case * * *." 28 USC §1447(c) (1964) amended by 28
10 USC §1447(c) (1988). That provision currently reads, "If at any
11 time before final judgment it appears that the district court
12 lacks subject matter jurisdiction, the case shall be remanded."
13 28 USC §1447(c). The argument set forth in Wright & Miller
14 rests on an expansive reading of the former language that would
15 allow a court to remand a case for lack of personal jurisdiction
16 or something closely resembling it. See Wright & Miller, § 1829
17 n34. Under the version of §1447(c) currently in force, this
18 avenue is blocked and remand at this juncture unavailable for
19 any reason other than the lack of subject matter jurisdiction,
20 which plaintiff cannot demonstrate here.

21 Plaintiff concedes the court's subject matter
22 jurisdiction based on diversity and also concedes his own lack
23 of standing to pursue this derivative action in federal court.
24 Dismissal is appropriate accordingly. See Holly Sugar Co v
25 Goshen Co Cooperative Beet Growers Ass'n, 725 F2d 564, 567-68
26 (10th Cir 1984); Ribbens International SA de CV v Transport
27 International Pool, Inc, 45 F Supp 2d 982, 984 n 2 (CD Cal
28 1999).

1 Plaintiff's second argument is that dismissal should be
2 without prejudice. The court concurs. The Ninth Circuit has
3 directed that an order dismissing a complaint pursuant to FRCP
4 12(b)(6) "should * * * inform the plaintiff of the reason for
5 dismissal so that he can make an intelligent choice as to
6 amending." Bonanno v Thomas, 309 F2d 320, 322 (9th Cir 1962)
7 (internal citation omitted). The Bonnano court accordingly
8 reversed the district court's dismissal without leave to amend.
9 See *id.* In cases in which a plaintiff's case is subject to
10 dismissal for a defect in the pleadings, district courts follow
11 the practice prescribed by Bonnano and furthermore, guided by
12 FRCP 15, routinely dismiss with leave to amend to correct the
13 identified defect(s) in the pleadings. See FRCP 15; Allen v
14 City of Beverly Hills, 91 F2d 367, 373 (9th Cir 1990).

15 Had plaintiff served an in-state defendant prior to the
16 time CSFB filed its answer and sought immediate removal,
17 plaintiff could not have been forced into a federal forum of
18 CSFB's choosing. See 28 USC §1441(b) ("Any [civil action not
19 founded on or arising out of a constitutional claim] shall be
20 removable only if none of the parties in interest properly
21 joined and served as defendants is a citizen of the State in
22 which such action is brought;" emphasis added); see also FAC
23 (Doc #59), ¶9 ("Plaintiff does not allege, either directly or
24 indirectly, any violation of any federal statute, regulation,
25 rule or, order * * *"). Under these circumstances, the court
26 concludes that CSFB's motion to dismiss (Doc #61) must be
27 GRANTED, but that dismissal should be without prejudice to
28 plaintiff's either amending the complaint to state a claim

1 cognizable in federal court or - what seems more likely -
2 commencing a new action in state court.

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4 III

5 For the reasons stated above, CSFB's motion to dismiss
6 (Doc #61) is GRANTED. The FAC is dismissed without prejudice.

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8 IT IS SO ORDERED.

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11 VAUGHN R WALKER
12 United States District Judge
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